

A "retailer maintaining a place of business in Illinois" as described in 86 Ill. Adm. Code 150.201(i) is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. (This is a GIL).

June 7, 2001

Dear Xxxxx:

This letter is in response to your letter dated January 18, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

The Illinois Department of Revenue's opinion is requested in regard to the questions on pages 2 and 3 of this letter.

FACTS

Company A is a graphic design/advertising agency which has an office in STATE. All of its employees are located in the office in STATE. Its revenues come from designing, developing and producing various items such as brochures, inserts, folders, mail campaigns, magazine ads, newsletters, tradeshow booth graphics, catalogs and website designs. Company A does not own or lease any property in Illinois. It does not have any non-employee representatives or agents. The only activity of its employees in Illinois is meeting with customers about 45 days per year to discuss project objectives of the client, presenting ideas or concepts, how ads might be marketed, etc.

Proposals for jobs with Illinois customers are faxed to the Illinois customer for signature. If the customer agrees with the proposal, it is faxed by the Illinois customer to Company A's office in STATE where it is received and approved.

Company A's transactions with Illinois clients may be structured in two different ways as described below:

Transaction 1

Customer enters into a contract with Company A to design, develop and print a specified number of brochures, folders, newsletters or catalogs. Company A will develop various concepts or ideas for the customer and after the customer accepts a specific concept or idea, Company A will hire a separate entity, that is, a printer in

STATE, to print the brochures, catalogs, etc. That printer will ship the brochures, catalogs, etc. directly to the customer in Illinois or at other locations at the direction of the Illinois customer. The printer may or may not have sales tax nexus in Illinois. Company A's billing to the customer in Illinois is comprised of a number of factors such as development or creative fees, media placement (e.g., placing an ad in a newspaper), printing charges, etc. The printer bills Company A for the printing, it does not bill Company A's customer.

Transaction 2

A customer enters into an agreement with Company A to develop ideas or concepts for a brochure, advertising campaign, catalog, etc. The concept or idea is transmitted to the customer in Illinois either electronically, by fax or by regular mail. After selecting one of the concepts or ideas, customer will then hire a third party printer to have the brochures or catalogs printed (rather than having Company A hire a printer). In such cases, the billing by Company A to the customer includes the charges for the development and design of those concepts or ideas. The printer directly bills the Illinois customer for the printing.

QUESTIONS

1. Based on the above facts, does Company A have nexus in Illinois for a) sales and use taxes, and b) corporate income taxes?
2. If Company A has nexus for sales and use taxes, is it a) required to register with the Illinois Department of Revenue, and b) liable for use tax on any of its purchases or sales tax on any of its sales?
3. If Company A has nexus and is required to register with the Illinois Department of Revenue to collect sales and use taxes, is it considered a 'serviceperson' as mentioned on page 10 of the Illinois ST-19 Retailers Tax Booklet (copy of page 10 is enclosed)? If Company A is a 'serviceperson', is it subject to the 35% threshold or the 75% threshold?
4. Computing 'cost ratio', 'annual aggregate costs' and 'annual gross receipts':

- a) For Transaction 1 above:

Annual Aggregate Costs:

- What items or materials are included in Company A's annual aggregate costs?
- Does it only include Company A's purchase (cost) of paper, ink and other tangible personal property it transfers to its customer in Illinois?
- Is the printer's cost of paper and ink (printer is hired by Company A) included in Company A's costs?
- Are any materials transferred to the customer outside of Illinois excluded from annual aggregate costs?

Annual Gross Receipts:

- Do 'annual gross receipts' include the total amount Company A bills the Illinois customer, which includes Company A's charges for its creative and design services, etc., plus the printer's charges (printer was hired by Company A)?
- If materials such as catalogs or brochures are shipped to the customer outside of Illinois, are receipts relating to such items excluded from 'annual gross receipts'?

b) For Transaction 2 above:

Annual Aggregate Costs:

- What items or materials are included in Company A's annual aggregate costs?
- Does it only include Company A's purchase (cost) of paper, ink and other tangible personal property it transfers to its customer in Illinois?
- Are any materials transferred to the customer outside of Illinois excluded from annual aggregate costs?

Annual Gross Receipts:

- Do 'annual gross receipts' include the total amount Company A bills the Illinois customer?
- If materials are shipped by Company A to the customer outside of Illinois, are receipts relating to such items excluded from 'annual gross receipts'?

If you have any questions about this request, please call me.

Thank you for your assistance.

DEPARTMENT'S RESPONSE:

In the context of a General Information Letter, the Department is unable to make nexus determinations because the amount of information required to make that determination is often best gathered by an auditor. The following information outlines the principles of nexus. We hope it is helpful to you in determining whether your client is responsible to pay tax in Illinois.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition

of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in Quill Corp. v. North Dakota, 112 S.Ct 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. Quill at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to Brown's Furniture, Inc. v. Zehnder, (1996), 171 Ill.2d 410.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State. The Use Tax rate is 6.25%.

For the purposes of the following discussion, we will assume that your client has nexus with the State of Illinois. For your information, we have enclosed a copy of 86 Ill. Adm. Code 130.2000, which is the regulation for "Persons Engaged in the Printing, Graphic Arts or Related Occupations, and Their Suppliers." As a general rule, when products are items of general utility and serve substantially the same function as stock or standard items, the products will be subject to the Retailers' Occupation Tax when sold. Items which serve substantially the same function are those which, when produced on special order, could be sold as produced to someone other than the original purchaser at substantially the same price.

Items that would not be considered stock or standard items and would not be sold to someone other than the purchaser for substantially the same price would not be subject to the Retailers' Occupation Tax when sold, but would be subject to the Service Occupation Tax. Special order or custom print items are generally not considered stock or standard items and are generally not sold to someone other than the purchaser for substantially the same price. Therefore special order or custom print items are generally subject to the Service Occupation Tax.

We are assuming that the items you are describing in your letter are custom items. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling

price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Generally, special order printers calculate their tax base utilizing either the third or fourth method. The third method only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See, 86 Ill. Adm. Code 140.101(f), enclosed. This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax are required to collect the Service Use Tax from their customers. They remit Service Occupation Tax to the tax to the Department by filing returns and do not pay tax to their suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers.

The fourth method of determining tax liability may be used by de minimis servicemen who are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

In computing the cost ratio, the annual aggregate cost price of tangible personal property transferred incident to all sales of service, not just sales made to Illinois service customers, must be considered. Similarly, in calculating his annual gross receipts from service transactions, a serviceman must include gross receipts from all his sales of service, not just those sales of service made to Illinois customers. We believe that the 75% threshold is applicable to your client, since he appears to function as a print broker.

It is difficult to determine, from the limited and hypothetical-type information contained in your letter, whether your client would incur a tax liability. It appears that your client would not, however, incur any Service Occupation Tax liability because it is not making sales of service in Illinois.

Transaction 1 involves a multi-service transaction between two out-of-State servicemen, in which your out-of-State client farms out what we have assumed to be custom printing work to an out-of-State subserviceman ("the STATE printer"). The STATE printer then drop ships custom printed materials from an out-of-State location to your client's Illinois service customer. For purposes of our response, we have assumed that your client both has nexus and qualifies as a de minimis serviceman eligible to remit Use Tax on its sales to Illinois customers. We have also assumed that the STATE printer drop ships the custom printed materials to your client's Illinois service customer. Your letter also states that the STATE printer may have nexus with Illinois. Even were all these assumptions to prove true, we do not believe that your client would incur any Use Tax liability. There is no use of the tangible personal property in Illinois which would trigger tax liability.

We must note that our conclusions would change if your client both had nexus and was ineligible to utilize the fourth method described above for handling his tax liability. If he was selling custom printed items to Illinois customers under these circumstances, he would be required to collect Service Use Tax from his Illinois customers. He should provide the STATE printer with a Certificate of Resale.

If the items which your client sells are not custom printed materials, your client must collect the Use Tax for any materials which are drop shipped to its Illinois customers. Your client should provide the STATE printer with a Certificate of Resale.

Under the Service Occupation Tax Act, an exemption exists for the sale, employment and transfer of such tangible personal property as newsprint and ink for physical incorporation into newspapers or magazines. See 86 Ill. Adm. Code 140.125(i), enclosed. In addition, Section 2 of both the Use Tax Act and the Service Use Tax Act provide that the purchase, employment and transfer of such tangible personal property as newsprint and ink for the primary purpose of conveying news (with or without other information) is not a purchase, use or sale of tangible personal property. 35 ILCS 105/2 and 35 ILCS 110/2 (1998 State Bar Edition).

The exemption for newspapers and magazines stems from the exemption afforded newsprint and ink under the sales tax acts. See 86 Ill. Adm. Code 130.2105, enclosed. The requirements for a publication to constitute a "magazine" have been clarified by case law. In *Moody's Investors Service, Inc. v. Department of Revenue*, 112 Ill.App.3d 1024, 68 Ill.Dec. 478, 445 N.E.2d 1331 (1983), the appellate court stated that one test must be met and several other factors are taken into consideration in determining whether a publication constitutes a "magazine." The publication must be published more than once a year. Quarterly, weekly, monthly or even semi-annual publications meet this test. Other factors which are taken into consideration are whether the magazine contains articles and items which are of value to the public, rather than to a specialized group of people; if it has the basic format of a magazine (such as a soft cover, individual pages, indexed articles); whether it can be subscribed to; whether it contains general advertising; and if it is commonly accepted as a magazine.

The Supreme Court of Illinois affirmed the appellate court's decision in *Moody's Investors Service, Inc. v. Department of Revenue*, 101 Ill.2d 291, 78 Ill.Dec. 138, 461 N.E.2d 972 (1984). An exemption certificate is not necessary in order to claim the newsprint and ink exemption. However, documentation recording such sales of newsprint and ink is recommended as part of the retailer's or serviceman's books and records.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

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MAJ:msk
Enc.